

PETRO-REEF RESOURCES LTD.

2020, 800 - 5TH AVE. S.W.
CALGARY, ALBERTA, T2P 3T6

Canada

Tel: (403) 265-6444

Fax: (403) 264-1348

1999

ANNUAL REPORT

Report To The Shareholders

During the 1999 fiscal year the Company drilled and completed two (2) wells in its core area of operations. One well was placed on stream in December, 1999 at 1.15 MMCF/D and the second well was production tested at 800 MCF/D and will be placed on stream by month end or shortly thereafter. In addition Petro-Reef drilled a new well in early March, 2000 which was completed by the setting of production casing and will be production tested and placed on stream after break-up.

Several potential pay zones were identified with this well and will require additional development drilling. Five (5) other wells in the area are still awaiting completion and tie-in.

During fiscal year 1999 the company expanded its core area of operations and increased its land position from 6665 gross acres to 12800 gross acres and its working interest position from an interest varying from 30.00% to 73.00% to an interest varying from 30.00% to 100.00%.

A total of 9.1 square miles of 3-D seismic were shot over 4480 acres of the company's lands during 1999 and early in 2000 using new state of the art 3-D interpretive techniques. With this seismic the company has identified several multi-zone oil and/or gas prospects and has drilled the three (3) new wells aforementioned. Three more locations have been picked and will be drilled after break-up. The three (3) wells drilled to-date plus the three (3) new wells should add significantly to the proven reserves and the net cash flow to the company. Once these wells have been drilled, completed and placed on stream the company will move to the development stage of drilling the additional wells required to place the remaining proven reserves on stream on these 4480 acres of prospect lands. Of the remaining 8320 acres of prospect lands that the company currently owns 7680 acres have been planned for 3-D seismic later in the 2000 or early in year 2001 with initial drilling to start shortly thereafter.

Asset value on the balance sheet increased from \$1,088,747.00 for 1998 to \$4,888,658 in fiscal year 1999 the majority of which is as a result of the purchase of petroleum and natural gas property interests and overriding royalty interests by the issuance of 3,665,868 common shares in the company. This purchase closed on September 27, 1999.

Gross revenue decreased from \$259,578 for 1998 to \$206,377 mainly as a direct result of a decrease in overhead recovery. Expenses increased from \$198,313 for 1998 to \$275,595. As a result net loss for fiscal year 1999 was \$69,218 versus a net earning of \$61,265 for fiscal year 1998.

With placing on stream of the new wells aforementioned revenue is anticipated to increase significantly for fiscal year 2000.

On behalf of the Company and its board of directors, I would like to thank the shareholders for their continued support. We will endeavour to meet and hopefully exceed your expectations with increases in cash flow per share and a higher share price for the Company for the fiscal year 2000.

Dated April 11, 2000

Signed "T.M. Donhuysen"
President and C.E.O.

PETRO-REEF RESOURCES LTD.
CORPORATION INFORMATION

Directors and Officers

Theodore M. Donhuysen

Chief Executive Officer

President & Director

Calgary Alberta

Joseph Werner

Chairman of the Board

Chief Financial Officer & Director

Calgary Alberta

Robert N. Maertens-Poole

Director

Calgary Alberta

Douglas W. Schneider

Director

Calgary Alberta

John Lagadin

Director

Calgary Alberta

Nobert Kloster

Director

Calgary Alberta

Head Office

2020 800 5th Avenue S.W.

Calgary, Alberta T2P 3T6

Canada

Telephone: (403) 265-6444

Facsimile: (403) 264-1348

**Legal Counsel and Corporate
Secretary**

R. Greg Powers

Assistant Secretary

Gary W. Coleman

Bank

HSBC Bank Canada

Auditors

PricewaterhouseCoopers

Registrar & Transfer Agent

CIBC Mellon Trust Company

Stock Listing

Canadian Venture Exchange

Symbol PER

Petro-Reef Resources Ltd.

Financial Statements

December 31, 1999 and 1998

March 10, 2000

Auditors' Report

To the Shareholders of
Petro-Reef Resources Ltd.

We have audited the balance sheets of **Petro-Reef Resources Ltd.** as at December 31, 1999 and 1998 and the statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Petro-Reef Resources Ltd.

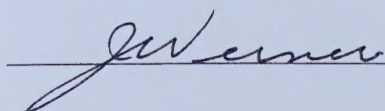
Balance Sheets

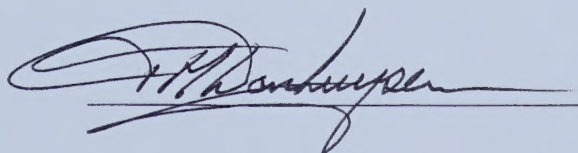
As at December 31, 1999 and 1998

	1999 \$	1998 \$
Assets		
Current assets		
Cash and short-term investments	304,395	185,289
Accounts receivable	180,703	153,075
Prepaid expenses and deposits	37,384	17,562
	522,482	355,926
Property, plant and equipment (note 2)	4,366,176	732,821
	4,888,658	1,088,747
Liabilities		
Current liabilities		
Accounts payable and accrued charges	466,430	245,796
Future site restoration	5,705	3,439
	472,135	249,235
Shareholders' Equity		
Capital stock (note 3)	4,424,476	778,247
(Deficit) retained earnings	(7,953)	61,265
	4,416,523	839,512
	4,888,658	1,088,747

The accompanying notes are integral to the financial statements.

Approved by the Board of Directors

 Director

 Director

Petro-Reef Resources Ltd.

Statements of Earnings and Retained Earnings For the years ended December 31, 1999 and 1998

	1999 \$	1998 \$
Revenue		
Oil and gas sales, net of royalties and ARTC	145,961	151,919
Overhead recoveries	54,727	97,381
Interest income	5,689	10,278
	<u>206,377</u>	<u>259,578</u>
Expenses		
Production	59,023	63,775
General and administrative	181,122	108,985
Depletion, depreciation and amortization	35,450	25,553
	<u>275,595</u>	<u>198,313</u>
Net (loss) earnings for the year	(69,218)	61,265
Retained earnings (deficit) – Beginning of year	61,265	(1,573,352)
Elimination of deficit (note 3)	-	1,573,352
(Deficit) retained earnings – End of year	<u>(7,953)</u>	<u>61,265</u>
Basic and fully diluted (loss) earnings per common share	<u>(0.01)</u>	<u>0.01</u>

The accompanying notes are integral to the financial statements.

Petro-Reef Resources Ltd.

Statements of Cash Flows

For the years ended December 31, 1999 and 1998

	1999 \$	1998 \$
Cash provided by (used in)		
Operating activities		
Net (loss) income for the year	(69,218)	61,265
Items not affecting working capital		
Depletion, depreciation and amortization	35,450	25,553
	(33,768)	86,818
Net change in non-cash operating working capital items	75,175	(37,041)
	41,407	49,777
Financing activities		
Issuance of common shares	534,898	25,000
Share issuance costs	(41,434)	-
	493,464	25,000
Investing activities		
Expenditures on property, plant and equipment	(513,774)	(76,943)
Net change in non-cash investing working capital items	98,009	16,053
	(415,765)	(60,890)
Change in cash and short-term investments during the year	119,106	13,887
Cash and short-term investments – Beginning of year	185,289	171,402
Cash and short-term investments – End of year	304,395	185,289
Basic and fully diluted cash flow per share	-	0.01

The accompanying notes are integral to the financial statements.

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

1 Accounting policies

Oil and gas operations

The company is engaged in the exploration for and production of oil and natural gas in Canada.

The company follows the full cost method of accounting for oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent in the depletion rate.

In applying the full cost method, the company calculates a cost ceiling which restricts the capitalized costs less accumulated depletion from exceeding the estimated future net revenue from proved reserves, based on year-end prices and production costs plus the net cost of undeveloped acreage, less future general and administrative expenses, financing costs, site restoration costs and income taxes.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the company includes the net book value of its proved oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves excludes the unimpaired cost attributable to unproved properties.

Estimated costs of future abandonment and restoration of well sites and associated facilities are amortized over the life of the properties on a unit-of-production basis.

Depreciation

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%.

Income taxes

The company follows the tax allocation method of accounting for income taxes whereby the income tax provision for the year is based on the income reported in the accounts. Under this method, the company provides for deferred income taxes as a result of claiming deductions for income tax purposes in excess of amounts claimed for financial statement purposes.

Stock options

The company does not record any compensation expense in respect of stock options granted to directors, officers and employees. The consideration paid by holders of the options upon exercise is credited to share capital.

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

Joint ventures

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

2 Property, plant and equipment

	1999		
	Cost \$	Accumulated depletion and depreciation \$	Net \$
Petroleum and natural gas	5,688,241	1,326,986	4,361,255
Furniture and fixtures	14,537	9,616	4,921
	<u>5,702,778</u>	<u>1,336,602</u>	<u>4,366,176</u>
	1998		
	Cost \$	Accumulated depletion and depreciation \$	Net \$
Petroleum and natural gas	2,022,701	1,294,882	727,819
Furniture and fixtures	13,538	8,536	5,002
	<u>2,036,239</u>	<u>1,303,418</u>	<u>732,821</u>

No interest or general and administrative expenses were capitalized during the year.

Unproven property costs of \$2,315,689 (1998 – \$67,037) have been excluded from capitalized costs subject to depletion.

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

3 Capital stock

The authorized share capital of the company is comprised of an unlimited number of preferred shares and an unlimited number of common shares. Details of the changes in the company's share capital during 1999 and 1998 are as follows:

	1999		1998	
	Number of shares	Amount \$	Number of shares	Amount \$
Common shares				
Balance – Beginning of period	12,271,494	778,247	12,171,494	2,326,599
Issued for cash equivalent consideration	676,438	508,648	-	-
Issued for the exercise of stock options	75,000	26,250	100,000	25,000
Elimination of deficit	-	-	-	(1,573,352)
Issued for acquisition of petroleum and natural gas property interests	2,871,181	2,431,162	-	-
Issued for purchase of overriding royalty	794,824	680,169	-	-
Balance – End of period	16,688,937	4,424,476	12,271,494	778,247

The company issued 2,871,181 common shares on September 27, 1999 as consideration for the acquisition of petroleum and natural gas property interests. On the same date, the company issued 794,824 shares for the acquisition of an overriding royalty interest. The transactions were recorded at \$0.86 per share which represents the ten day average trading price around the date of issue.

Earnings per common share are calculated using the weighted average number of common shares outstanding during the year of 13,438,020 (1998 – 12,251,494).

Pursuant to a special resolution passed at a special meeting of the shareholders of the Company on May 1, 1998, the company's stated capital was reduced by offsetting the deficit in the amount of \$1,573,352 and the share capital amount by \$1,573,352.

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

Stock options

The company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the company's stock on the date of grant. Options are fully vested at the date of grant and expire after a maximum exercise period of three years from the date of issuance. As at the date hereof, there are a total of 1,222,000 options granted under the stock option plan outstanding as follows:

	1999		1998	
	Shares	Weighted-average exercise price \$	Shares	Weighted-average exercise price \$
Outstanding – Beginning of year	1,217,000	0.31	1,217,000	0.29
Granted	230,000	0.62	100,000	0.45
Exercised	(75,000)	0.35	(100,000)	0.25
Expired	(150,000)	0.25	-	-
Options exercisable at year end	1,222,000		1,217,000	

The following table summarizes information about fixed stock options outstanding at December 31, 1999:

	Options outstanding			Options exercisable	
Range of Exercise price	Number outstanding	Weighted-average remaining contractual life	Weighted-average exercise price (\$/share)	Number exercisable	Weighted-average exercise price (\$/share)
\$0.25 – \$0.30	800,000	0.09 years	0.27	800,000	0.27
\$0.45 – \$0.49	230,000	1.83 years	0.47	230,000	0.47
\$0.60 – \$0.80	192,000	1.60 years	0.70	192,000	0.70
	1,222,000	1.07 years	0.37	1,222,000	0.37

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

4 Income taxes

At December 31, 1999, the company has approximately \$2,649,169 (1998 – \$1,893,000) of tax pools available for deduction from future taxable income of which \$427,007 (1998 – \$427,007) are successor pools. In addition, the company has non-capital tax losses of approximately \$341,850 (1998 – \$309,550) the benefit of which has not been reflected in these financial statements due to a lack of virtual certainty of realizing the tax benefit.

These losses expire as follows:

Expiry date	Amount \$
2001	179,056
2002	67,733
2003	62,721
2004	-
2005	32,300

The income tax provision differs from the amount computed by applying the expected income tax rate of 44.62% (1998 – 44.62%) to earnings before taxes. The reasons for this difference are as follows:

	1999 \$	1998 \$
(Loss) earnings before taxes	(69,218)	61,265
Effective tax rate	44.62%	44.62%
Expected tax expense (recovery) at combined federal and provincial rates	(30,885)	27,336
Crown royalties and production taxes	11,934	10,512
Alberta royalty tax credit	(8,216)	(7,290)
Crown lease rentals	(1,225)	(1,419)
Resource allowance	-	(7,632)
Other	13,980	5,515
Benefit of losses (recognized) not recognized	14,412	(27,022)
	-	-

5 Commitments

The present office lease agreement expires on August 31, 2003. Future lease payments over the next three years (2000 – 2002) under the company's office lease total will be \$42,032 per year. The lease payments for 2003 will total \$28,021.

Petro-Reef Resources Ltd.

Notes to Financial Statements

December 31, 1999 and 1998

6 Related party transactions

In 1999, companies controlled by directors of Petro-Reef received \$Nil (1998 – \$25,000) as remuneration for their services.

In 1999, Petro-Reef issued 794,824 shares for the purchase of 1½% overriding royalties from two companies controlled by directors of Petro-Reef.

In 1999, a company controlled by a director of Petro-Reef, provided geophysical consulting to Petro-Reef, for an amount of \$7,490.

7 Financial instruments

Financial instruments include cash and short-term investments, accounts receivable, and accounts payable and accrued charges. At December 31, 1999, the fair market value of the financial instruments approximated their carrying value due to the short-term maturity of these instruments.

